DEPARTMENT OF STATE REVENUE

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Letter of Findings Number: 09-0661
Use Tax
For Tax Years 2006-08

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ISSUE

I. Use Tax–Overhead Cranes.

Authority: IC § 6-2.5-2-1; IC § 6-2.5-3-2; IC § 6-8.1-5-1; 45 IAC 2.2-5-8.

Taxpayer protests the imposition of use tax on its purchase of several overhead cranes.

STATEMENT OF FACTS

Taxpayer is an Indiana business in the steel industry. As the result of an audit, the Indiana Department of Revenue ("Department") determined that Taxpayer had not paid sales tax on certain purchases of tangible personal property, including overhead crane repair components. The Department therefore issued proposed assessments for use tax, ten percent negligence penalties, and interest for the tax years 2006, 2007, and 2008. Taxpayer protests the imposition of use tax on overhead crane repair components it purchased during these years. Taxpayer also protested the imposition of ten percent negligence penalties, which the Department waived in an earlier stage of the protest process. This Letter of Findings therefore only addresses Taxpayer's protest regarding the overhead crane repair components. An administrative hearing was held and this Letter of Findings results. Further facts will be supplied as required.

I. Use Tax–Overhead Cranes.

DISCUSSION

Taxpayer protests the imposition of use tax on overhead crane repair components during the tax years 2006-08. The Department determined that the cranes were used in pre-production and post-production capacities and the repair components were therefore taxable. In the course of the audit, the Department visited Taxpayer's plant and examined the use of Taxpayer's equipment. The Department found the use of the cranes to be outside the uses which qualify for the manufacturing exemption. Taxpayer protests that it called the Department several times for advice on the taxable status of the cranes and that its use of the cranes met the standard described by the Department. The Department notes that the burden of proving a proposed assessment wrong rests with the person against whom the proposed assessment is made, as provided by IC § 6-8.1-5-1(c).

The first relevant statute is IC § 6-2.5-2-1, which states:

(a) An excise tax, known as the state gross retail tax, is imposed on retail transactions made in Indiana.

(b) The person who acquires property in a retail transaction is liable for the tax on the transaction and, except as otherwise provided in this chapter, shall pay the tax to the retail merchant as a separate added amount to the consideration in the transaction. The retail merchant shall collect the tax as agent for the state.

Also, Indiana imposes a complementary use tax under IC § 6-2.5-3-2(a), which states:

An excise tax, known as the use tax, is imposed on the storage, use, or consumption of tangible personal property in Indiana if the property was acquired in a retail transaction, regardless of the location of that transaction or of the retail merchant making that transaction.

Next, IC § 6-2.5-5-3 states:

(a) For purposes of this section:

(1) the retreading of tires shall be treated as the processing of tangible personal property; and

(2) commercial printing shall be treated as the production and manufacture of tangible personal property.

(b) Except as provided in subsection (c), transactions involving manufacturing machinery, tools, and equipment are exempt from the state gross retail tax if the person acquiring that property acquires it for direct use in the direct production, manufacture, fabrication, assembly, extraction, mining, processing, refining, or finishing of other tangible personal property.

(c) The exemption provided in subsection (b) does not apply to transactions involving distribution equipment or transmission equipment acquired by a public utility engaged in generating electricity.

(Emphasis added).

45 IAC 2.2-5-8 states in relevant parts:

...

(c) The state gross retail tax does not apply to purchases of manufacturing machinery, tools, and equipment to be directly used by the purchaser in the production process provided that such machinery, tools, and equipment are directly used in the production process; i.e., they have an immediate effect on the article being produced. Property has an immediate effect on the article being produced if it is an essential and integral part of an integrated process which produces tangible personal property.

(d) Pre-production and post-production activities. "Direct use in the production process" begins at the point of the first operation or activity constituting part of the integrated production process and ends at the point that the production has altered the item to its completed form, including packaging, if required.

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(f) Transportation equipment.

(1) Tangible personal property used for moving raw materials to the plant prior to their entrance into the production process is taxable.

(2) Tangible personal property used for moving finished goods from the plant after manufacture is subject to tax.

(3) Transportation equipment used to transport work-in-process or semi-finished materials to or from storage is not subject to tax if the transportation is within the production process.

(4) Transportation equipment used to transport work-in-process, semi-finished, or finished goods between plants is taxable, if the plants are not part of the same integrated production process.

–EXAMPLES–

(1) A manufacturer of clay pipe uses forklift tractors to transport the pipe from the machine in which it is formed to the kiln. The forklift tractors are exempt.

(2) A metal and alloy manufacturer pulverizes raw materials for use in an exempt furnace. Weigh bins are utilized for the temporary storage of the exempt materials after pulverization and prior to use in an exempt furnace. Transportation equipment used to transport the pulverized raw material to and from the weigh bins is exempt.

(3) A forklift is used exclusively to move work-in-process from a temporary storage area in a plant and to transport it to a production machine for processing. Because the forklift functions as an integral part of the integrated system comprising the production operations, it is exempt.

(4) A forklift is used exclusively to move finished goods from a storage warehouse and to load them on trucks for shipment to customers. The forklift is taxable because it is used outside the integrated production process.

(5) A forklift is regularly used 40% of the time for the purpose described in Example (3) and 60% of the time for the purpose described in Example (4). The taxpayer is entitled to an exemption equal to 40% of the gross retail income attributable to the transaction in which the forklift was purchased.

. . ..

(Emphasis added).

Therefore, any piece of equipment must be directly used in the direct production of tangible personal property to qualify for the manufacturing exemption, as provided by 45 IAC 2.2-5-8(c) and IC § 6-2.5-5-3(b). This is commonly referred to as the "double-direct" test.

As part of the protest process, Taxpayer provided analysis and supporting documentation explaining the functions and uses of the overhead cranes. After review of these materials, the Department's original determination is confirmed. The cranes are used to load steel coils off of and onto trucks, and onto and off of manufacturing equipment. The cranes do not move steel within the production process. Once the steel is processed on one of Taxpayer's lines, it is either recoiled or stacked for reloading onto trucks. All of these activities are considered pre-production or post-production activities. While undoubtedly necessary to move the extremely heavy loads of steel, the cranes do not directly take part in the direct production of tangible personal property.

Taxpayer states that, over the course of several calls to the Department to determine how to treat the cranes for sales and use tax, several Department personnel told Taxpayer that the cranes would be considered exempt if they were "deemed necessary" to the production process. Since these were telephone calls, Taxpayer did not have a written statement to support this explanation. While Taxpayer may have had such conversations with the Department, the Department takes this opportunity to affirm that the "deemed necessary" phrase to which Taxpayer refers is not correct. The proper standard is the "double-direct" test, as explained above.

Still, the Department acknowledges that Taxpayer was making a good-faith effort to comply with Indiana's tax laws. This is a factor normally associated with the imposition and/or waiver of negligence penalty. As previously discussed, the Department initially imposed penalties but later waived those penalties at a stage prior to the administrative hearing.

In conclusion, the repair components for the overhead cranes are not eligible for the manufacturing exemption. This is because the cranes do not meet the criteria of the "double-direct" test. The Department acknowledges Taxpayer's compliance efforts, which is why the Department previously waived the negligence penalties.

FINDING

Taxpayer's protest is denied.

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